Mortgage Reform Bill (AB 1830)
Summary

AB 1830 represents a balanced and common sense approach to reign in the abuses that occurred in the subprime market. California will lead the nation in following up on the recent amendments to Federal Regulation Z by adopting additional stringent standards and regulations for brokers and lenders.

AB 1830 strikes the correct balance between eliminating the abuses in the subprime market and maintaining viable home ownership options across California's diverse communities. With California's high housing prices, it is vital that products and practices that can save the consumer money be available so long as those products and practices are used responsibly. It would be unacceptable to further widen the minority home ownership gap or inadvertently harm consumers without high incomes.

Some subprime lending has helped millions of people achieve the American Dream. It is irresponsible subprime lending that needs to be eliminated. AB 1830—with its strong focus on preventing misconduct by brokers and lenders—seeks to eliminate irresponsible subprime lending, while preserving access to homeownership.

I. ELIMINATING ABUSIVE PRACTICES

Directly Prohibits Steering:

AB 1830 directly prohibits a broker from steering borrowers to accept a loan at a higher cost than that which the consumer could otherwise qualify for. Additionally, a mortgage broker that only originates subprime loans must disclose that fact to a borrower prior to offering services. AB 1830 seeks to eliminate the practices that put people into costlier, higher-risk loans above what they had qualified for.

Eliminates Compensation Incentives That Led To Riskier Loans:

The subprime marketplace has incentives, including yield spread premiums that entice brokers to put borrowers into costlier loans without the knowledge of the borrower. The current structure of compensation provides a perverse incentive to steer borrowers to a riskier loan in order to increase the broker's compensation. AB 1830 eliminates this incentive by requiring that regardless of who pays the broker (borrower, lender or third party), the compensation must be the same. This will ensure that a broker can receive no more from a lender than the borrower would pay to the broker in up-front costs.

This removes the incentive to steer borrowers while ensuring that consumers can make informed choices about how to pay for their loan costs.

Directly Prohibits Deceptive Statements:

AB 1830 contains a prohibition against brokers and lenders from making false or deceptive statements connected with a subprime loan. This will require lenders and brokers to be upfront and honest in subprime loan transactions and ensure that borrowers are not misled with false statements about their loan.

Enacts Strong Fiduciary Duty Standard:

AB 1830 codifies a fiduciary duty standard for mortgage brokers across all loan products. A violation of this duty will make a broker subject to a violation of their license as well as strong civil liability and penalties.

AB 1830 provides that a mortgage broker owes a borrower, regardless of loan type, a fiduciary duty. This duty expressly includes a requirement that a mortgage broker must place the economic interest of the borrower ahead of the broker's own economic interest.

II. REGULATING PRODUCTS

Bans Negative Amortization Loans:

Many option ARM loans included scheduled payments that would lead the borrower to owe more on the loan than its original balance. Once this happens, the borrower is subject to an extreme payment shock to make the adjustment or a balloon payment to cover the difference. AB 1830 prohibits any subprime loan that could lead to negative amortization. The pool of borrowers in the subprime market is already riskier. Allowing an extremely risky product such as a negative amortization loan to be offered to this pool is not sound policy.

Puts Caps On Prepayment Penalties:

When used correctly, prepayment penalties have made it possible for subprime borrowers to get into a home even though they have increased credit risks, but prepayment penalties have also been abused in the subprime market and it is the abuse that AB 1830 seeks to eliminate.

AB 1830 builds on the provisions of Regulation Z and caps the amount of the penalty to no more than 2% of the principal balance in year one of the loan, and no more than 1% of the principal balance in the second year.

AB 1830 also prohibits anyone who arranges a subprime loan from receiving increased compensation for originating a loan that includes a prepayment penalty.

III. PENALTIES AND ENFORCEMENT:

AB 1830 establishes strong penalties and enforcement mechanisms to prevent abusive subprime lending.

- Provides for a civil penalty of up to $10,000 for a knowing and willful violation.
- Provides borrowers with a private right of action and the ability to recover attorney's fees.
- Provides that a licensing agency may prohibit licensees from engaging in acts or practices in connection with subprime loans that the agency finds to be unfair, deceptive, or designed to evade the law.
- Provides explicit authority for California regulators (DRE, DOC & DFI) to enforce provisions of federal lending laws against their licensees and furthermore provides that violations of federal lending laws are also a violation of that person's license.